South Carolina Legislative Audit Council

LAC

Report to the General Assembly

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A Review of the State Housing Finance and Development Authority's Homeownership Program

Legislative Audit Council

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Abbreviations

Authority	State Housing Finance and Development Authority
FHA	Federal Housing Administration
HUD	US Department of Housing and Urban Development
IRS	Internal Revenue Service
VA	Veterans Administration

Executive Summary

We were asked to review the South Carolina State Housing Finance and Development Authority's (the authority) homeownership program. Through the sale of tax-exempt mortgage revenue bonds, the authority makes below-market-rate mortgages available to low and moderate income families.

Our review focused on program results: who has been served by this program and have the results been in accordance with its authorizing legislation? We found that the authority, for the most part, has administered the program in compliance with state and federal requirements and has implemented some initiatives to serve low income people. However, we also found indications that the homeownership program has served higher income families than would be desired for optimum program results. We also identified problems with the authority's financial resource management and planning.

To answer our audit request and our overall objective of determining whether the program has met its goals and objectives as set out by state and federal legislation, we developed specific audit objectives which guided our work. A summary of the findings for each of these objectives follows.

Audit Objectives and Summary of Results

Determine the income ranges of loan recipients.

We found the authority has substantially complied with state and federal requirements for the income levels of loan recipients. There are two groups of people to be served according to state statute, the "low income" class (less than 75% of state median income), and the "moderate to low income" class (from 75% to 150% of state median income, see p. 10). We found the authority has primarily served the "moderate to low" group. South Carolina has served higher income families, on average, than other southeastern states (see p. 7).

Determine whether the authority's borrowers could have qualified for private, conventional mortgages.

Based on our analysis of 2,717 loans made from 1987 through June 1990, we estimated that more than two thirds (68%) of these borrowers probably could have qualified for private conventional or federally insured loans. The difference in interest rates for authority loans and conventional loans (1.24 percentage points) has not been great enough to make homeownership affordable for a large number of borrowers who could not afford private mortgages (see p. 13).

Determine the amount of funds going to rural and urban areas.

We found that the program has primarily served urban areas. Seven counties received approximately 75% of the loan funds for 1987 through June 1990, and rural areas have been underserved. Also, the authority could improve its advertising and publicity of the homeownership program in underserved counties (see p. 17).

Determine the number of minorities who have obtained mortgages.

The authority has relied on lenders to furnish minority data, and the reliability of this data is questionable. Authority records indicate that 17% of the loans (which account for 15% of the mortgage funds) have gone to minorities from 1987 through June 1990 (see p. 21).

Review the authority's methods of targeting selected borrowers to maximize program results.

The authority has used loan targeting strategies, such as designating "targeted areas," and offering exclusive reservation periods for low income families. We recommend that they consider using purchase price limits and additional family size adjustments as a further means to better ensure that mortgages go to those who most need them (see p. 23).

Review alternative strategies which could be used to assist lower income families in purchasing homes.

We identified seven programs which the authority has implemented to serve low income families and also report on additional initiatives that have been carried out in other states (see p. 29).

Determine if the authority has surplus funds which could be used to assist lower income families in purchasing homes.

We found that, as of June 30, 1990, the authority had $22.9 million in unrestricted bond funds (some of which was committed), and $5.2 million in an agency program fund that can be used for any agency purpose. However, the authority has not clearly identified available resources and has not adequately planned for their use (see p. 35).

Review the financial security of the bonds.

The authority has issued bonds that are financially secure. The bond issues that we examined have been highly rated by professional rating agencies, and the loans are insured and backed by reserve funds (see p. 40).

Review the agency's controls for ensuring that borrowers meet program guidelines.

We found that the authority has sufficient levels of review to provide reasonable assurance that their borrowers meet program requirements. Also, we reviewed 79 loan files and a printout of information detailing 2,717 loans, and found that all the loans reviewed met the authority's program requirements (see p. 42).

Because some of our objectives required information rather than evaluation, portions of the report do not contain traditional audit findings and recommendations. The following pages discuss in more detail the results of our review. Our findings are supported with information on the background of the program and how it works, explanations of additional problems we found, and recommendations for improvement.

Introduction and Background

Scope and Methodology

The audit focused on results of the authority's homeownership program and excluded consideration of other agency programs. To conduct this audit, we examined statistical information pertaining to all agency mortgage revenue bond issues since the program's inception in 1979. We conducted more detailed analyses of loans, bonds, and program management for the period from 1987 through June 1990.

We examined the authority's loan files, loan originator guides, official bond documents, and computer generated information about loans and borrowers. We examined the agency's bond accounting records, audited financial statements and professional rating agency opinions of the authority's bonds. We also interviewed authority officials, federal officials and officials with housing authorities in other states. We reviewed initiatives other states have taken to assist lower income families in purchasing homes.

The primary criteria we used to assess program results were the state and federal statutes establishing the homeownership program. The federal statutes contain provisions governing the use of mortgage revenue bonds for homeownership. We also reviewed the reports of other state and federal performance auditing agencies about homeownership programs in other states and localities.

To achieve our audit objectives, we relied on computer-processed data maintained by the authority in its portfolio management system (PMS). We reviewed the PMS and found the agency's internal controls for financial loan information to be adequate. However, the data entry controls for borrower demographic information were inadequate. We reviewed a judgmental sample of 79 loan files, selected because the likelihood of error was high, and found an error rate of 12.7%. We concluded that there was doubt about the reliability of some data we relied on. However, when this data was viewed in context with other available evidence, we believe the opinions, conclusions, and recommendations in this report are valid.

This audit was conducted in accordance with generally accepted government auditing standards.

Background and History

The South Carolina State Housing Finance and Development Authority was created in 1971. The authority was given the same mandate as that of local housing authorities, to provide decent, safe, and sanitary housing for low income persons. In addition to the homeownership program which we reviewed, the authority operates several rental housing programs. It also administers the Low Income Housing Tax Credit Program, and three rent subsidy programs as the agent for the U.S. Department of Housing and Urban Development.

The powers of the authority are vested in a board of commissioners. The board has seven members, appointed by the Governor, who are required to have experience in the fields of mortgage finance, banking, real estate, and home building. Additionally, the Governor, the State Commissioner of Health and Environmental Control, and two members of the General Assembly serve as ex officio commissioners. As of FY 90-91, the authority has 66 authorized full-time staff positions. While the authority receives state appropriations, it is required to repay the state appropriation used, to the extent possible, after the close of each fiscal year. Authority records indicate that it has repaid state appropriations in full each year since FY 79-80.

Tax Exempt Bonds Finance Mortgages

In 1977, the authority's powers were expanded to enable it to issue bonds and use the proceeds to finance mortgage loans for persons of "low income" and "moderate to low income." These groups (called beneficiary classes) include those whose gross household income is no greater than 150% of statewide median income. Prior to 1990, the authority believed it had to make loans available to persons of all income levels within this limit. State law was amended in March 1990 to, in effect, give the authority discretion in determining income levels of those who may obtain mortgage loans (within lawful limits). Federal law has also established income limits and other requirements for the program (see Table 1.2).

From January 1979 through June 1990, the authority issued $902.6 million in tax exempt mortgage revenue bonds (see Table 1.1). The bonds are an obligation of the authority, and the state is not liable for their repayment.

Table 1.1: Summary of Authority's Mortgage Revenue Bond Issues (As of June 30, 1990)

			Recipients		
Bond Issue	Amount Issued	Amount Loaned	Number of Loans	Total in Households	Mortgage Interest Rate (Fixed)
1979A	$84,865,000	$76,094,454	2,347	6,322	7.75%
1979B	170,275,000	164,425,149	4,409	11,530	8.00%
1982A	82,265,000	80,261,760	2,069	4,812	11.95%
1983A	58,000,000	43,971,477	1,078	2,461	11.20%
1983B	41,810,000	53,493,812[a]	1,330	3,068	11.10%
1984A	80,000,000	73,140,650	1,621	3,746	10.75%
1985A	40,000,000	36,527,590	806	1,822	10.25%
1985B	155,000,000	120,297,302	2,669	6,011	9.85%
1987A	25,000,000	24,035,050	447	1,116	9.50%
1988A	38,000,000	36,376,521	647	1,618	9.25%
1988B,C-1	30,000,000	31,450,506[b]	548	1,270	8.50%
1988C-2	30,000,000	26,507,677	425	972	8.20%
1989A	20,000,000	15,082,196	310	682	8.20%
1990A,B	47,385,000	1,228,792	21	36	8.40%
Totals	$902,600,000	$782,892,936	18,727	45,466	

[a]Amount loaned exceeds amount issued because funds remaining under 1983A were transferred for distribution under 1983B, at a blended mortgage interest rate.
[b]Amount loaned exceeds amount issued because all fees collected (for example, discount points) were used to finance additional mortgages.
Source: State Housing Finance and Development Authority.

Governmental units, such as the authority, issue bonds which are attractive to the investor because the interest earned is exempt from federal and state income taxes. They use bond funds to provide mortgages at below-market interest rates to first-time home buyers. The federal government, in effect, provides a substantial indirect subsidy by foregoing tax revenues on interest that investors earn on the bonds. In order for the bonds to be "qualified mortgage bonds" (thus, tax exempt), the authority must comply with federal laws governing these bond issues. Some of the more significant requirements, for the purpose of this review, relate to the eligibility of the borrower, and are summarized in Table 1.2. In addition, federal law limits the amount that the authority can earn from interest charged on mortgages (see p. 35).

Table 1.2: Significant Federal Eligibility Requirements to Obtain a Mortgage

In order to participate in the homeownership program, borrowers must meet the following requirements:

- Home buyer without an ownership interest in a principal residence for the three previous years (first-time buyer);
- Household income, for a family of 3 or more, not to exceed 115% of applicable median family income; for a family of 1 or 2, not to exceed 100% of applicable median; (in 1990, South Carolina's median family income was $31,500.)
- Purchase price not to exceed 90% of average area purchase price;
- Property must be a single-family residence, to be used as principal residence of borrower.

For poorer areas, called targeted areas, the first-time buyer requirement is waived, and income and purchase price limits are higher.

Source: Internal Revenue Code (26 U.S. §143).

How the Program Works

The authority's homeownership program is funded by "private activity bonds." Federal law allows each state to issue a certain volume of tax exempt private activity bonds each calendar year. Private activity bonds benefit private citizens rather than governmental entities, and include small issue industrial revenue bonds, student loan bonds, and certain other bonds, in addition to qualified mortgage bonds. South Carolina's ceiling (or cap) for 1989 was $174,650,000, of which $27,385,000 was allocated to the authority. When the authority believes that a sufficient demand exists for additional mortgage funds, and that market conditions are favorable, it is required, by state law, to obtain approval from the State Budget and Control Board to issue bonds. The bond offering is structured to make it attractive to investors, provide a sufficient spread between the program's mortgage rate and the conventional market rate to make it attractive to home buyers, and meet federal and state requirements. Prospective home buyers apply for financing through mortgage lenders approved by the authority. The lender makes the loan after determining that the borrower meets the program requirements; and the authority, after checking that the requirements have been met, purchases the loan from the lender with bond proceeds.

Federal Authorization for Tax Exempt Bonds

The federal authorization for tax exempt mortgage revenue bonds has, by law, expired several times since the early 1980's, but Congress has each time reauthorized the program. In October 1990, Congress reauthorized mortgage revenue bonds through December 31, 1991.

Program Results--Who Has Been Served

Introduction

Many of our audit objectives concern the results of the authority's homeownership program and ask the general question--who has been served? We examined program results from several perspectives. We reviewed the income levels of loan recipients compared to statutory requirements and recipients' income in other states. We considered the extent to which the authority's borrowers could have obtained private loans. We also reviewed the geographic distribution of the authority's funds to rural and urban areas and the percent of funds going to minority recipients.

Income of Families Obtaining Mortgages

The purpose of the authority's homeownership program is to assist moderate and low income families in obtaining mortgages at below-market interest rates. In order to evaluate the results of the program based on the income of those who have obtained mortgages, we reviewed income limits set by the authority for loan recipients since 1979, in conjunction with the requirements of state and federal law. We conducted a detailed analysis of income of families obtaining mortgages under bonds issued from 1987 through March 1990, and compared the income levels of South Carolina recipients with recipients in seven other southeastern states.

Methods for Establishing Income Limits

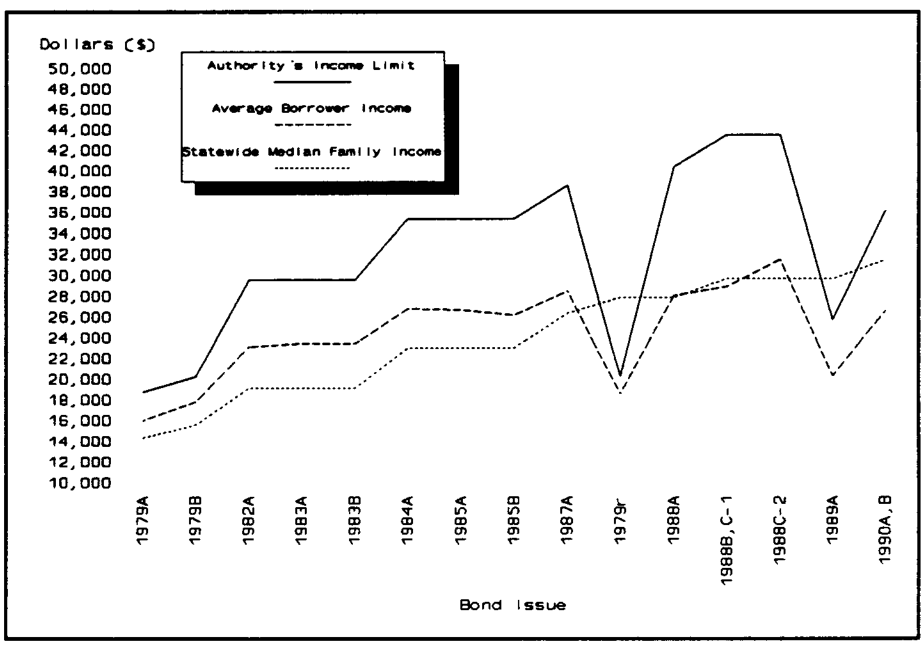
We reviewed the authority's records and found that the authority has substantially complied with state and federal laws in determining income limits of families who can be served. State and federal law governing the program has been amended several times since 1979. Currently, federal law establishes income limits based on family size and either median income of the area where the family resides or statewide median income (whichever is greater).

In March 1990, state law was amended to allow the authority to, in effect, serve lower income families than had previously been served. Prior to this amendment of §31-13-200(c) of the South Carolina Code of Laws, the authority, upon the advice of bond counsel, made mortgage financing equally available to all persons falling within the state statutory definition of "beneficiary classes" (which included families whose gross income was as high as 150% of statewide median income).

For its three most recent bond issues (1990A, B, and C), the authority set income limits at 100% of median income for families of two or less ($31,500), and 115% of median income for families of three or more ($36,225, rounded by the authority to $36,200). These limits were based on the maximum allowed by federal law for nontargeted areas (see p. 23).

The authority's income limits, average borrower income, and state median income are charted in Graph 2.1. The program limits have generally been higher than state median income, with the exception of two programs targeted to low income families (see p. 29).

Graph 2.1: Authority Income Limits, Average Borrower Income, and Statewide Median Family Income



Source: State Housing Finance and Development Authority, State Budget and Control Board, and U. S. Department of Housing and Urban Development. Appendix A provides exact figures and explanatory notes.

Income Ranges of Loan Recipients

The authority's records reflect that, for bond issues 1987A through 1990A and B, mortgage loans were made to families in the income ranges shown in Table 2.1.

Table 2.1: Number of Loan Recipients by Income Range (1987 through June 30, 1990)

Income Range	Number of Loans	Loan Amount	Percentage
$7,500 - $11,999	9	$286,328	.20%
$12,000 - $17,999	275	$10,404,693	7.10%
$18,000 - $24,999	838	$39,428,451	26.92%
$25,000 - $32,999	984	$56,184,279	38.36%
$33,000 - $39,999	558	$36,381,650	24.84%
$40,000 and Above	53	$3,769,581	2.57%
Total	2,717	$146,454,982	100.00%

Source: State Housing Finance and Development Authority.

We also obtained cumulative income range statistics from the start of the program in 1979 through bond issues 1990A and B (Table 2.2).

Table 2.2: Number of Loan Recipients by Income Range (1979 through June 30, 1990)

Income Range	Number of Loans	Loan Amount	Percentage
$7,500 - $11,999	572	$15,160,060	1.94%
$12,000 - $17,999	4,218	$142,423,125	18.19%
$18,000 - $24,999	7,259	$291,703,940	37.26%
$25,000 - $32,999	5,131	$247,686,081	31.64%
$33,000 - $39,999	1,383	$78,451,310	10.02%
$40,000 and Above	164	$7,468,420	.95%
Total	18,727	$782,892,936	100.00%

Source: State Housing Finance and Development Authority.

Who Has Been Served

We reviewed the income levels of families who have been served by the program from 1987 through June 30, 1990, by individual bond issue. We calculated the percentage of families who fell within the state-defined "low income" beneficiary class, those whose household income was less than 75% of statewide median income. We compared this percentage with the percentage of recipients within the "moderate to low income" class, those whose household income fell between 75% and 150% of statewide median income (see Table 2.3 on p. 11). In 1990, families in the "low income" group earned less than $23,625, and families in the "moderate to low income" group earned from $23,625 to $47,250. However, the authority's limits allowed only those earning as much as $36,200 to participate in the program.

We found that the authority's bond issues have primarily served the "moderate to low income" class. Only the 1979 reissue funds and the 1989A bond issue, targeted to lower income families, served primarily the "low income" class.

Table 2.3: Number of Recipients in Beneficiary Classes

Bond Issue	Moderate to Low Income Recipients	Low Income Recipients	Percentage of Low Income
1987A	431	16	3.7%
1979r[a]	59	260	81.5%
1988A	541	106	16.4%
1988B,C-1	433	115	21.0%
1988C-2[b]	418	7	1.7%
1989A[b]	102	208	67.0%
1990A,B	18	3	14.3%
Total	2,002	715	35.7%

[a]The 1979 reissue (in 1988) was not a new bond issue; rather, it consisted of funds available from 1979 loans paid off early. The authority applied the income limits used in 1979.
[b]Since bond issues 1988C-2 and 1989A were marketed together, the authority was able to establish lower income limits for 1989A. Therefore, the authority served a large number of low income families.
Source: State Housing Finance and Development Authority.

Income Limits in Other Southeastern States

We contacted officials in housing agencies in seven southeastern states to determine the way in which they set income limits and the average income of borrowers, from 1987 through 1989. We found that four states (Alabama, Florida, Mississippi and Tennessee) established income limits based on the maximum allowed under federal law, as did South Carolina during substantially the same time period. Three states (Georgia, North Carolina and Virginia) applied lower limits.

Analysis of Income Results in the Southeastern States

We compared the average borrower's income with the statewide median household income in eight southeastern states, including South Carolina, from 1987 through 1989. As Table 2.4 shows, on average, all of the states except Alabama have served people making at or slightly

Table 2.4: Southeastern States Comparison of Average Borrower Income with Statewide Median Income

State	Year	Average Borrower Income	State Median Income	Borrower Income as % of Median Income[a]
Alabama	1987	$25,000	$23,900	110%
	1988	$28,100	$24,200	
	1989	$28,937	$26,500	
Florida	1987	$28,020	$27,800	97%
	1988	$29,559	$29,100	
	1989	$27,982	$31,400	
Georgia	1987	$25,889	$28,400	88%
	1988	$26,705	$30,000	
	1989	$26,885	$32,100	
Mississippi	1987	$21,433	$21,400	100%
	1988	Not Available	$21,500	
	1989	Not Available	$23,400	
North Carolina	1987	$24,232	$26,600	79%
	1988	$21,210	$28,300	
	1989	$21,533	$30,200	
South Carolina	1987	$28,371	$26,400	98%
	1988	$25,574	$27,900	
	1989	$28,684	$29,700	
Tennessee	1987	$18,188	$24,400	77%
	1988	$20,181	$24,600	
	1989	$20,385	$26,900	
Virginia	1987	$27,941	$31,800	85%
	1988	$29,516	$33,500	
	1989	$28,995	$36,300	
Average of States Other than South Carolina[b]				89%
South Carolina Average				98%

[a]Average percentage of years compared.
[b]Mississippi was excluded from the average because of incomplete data.
Source: National Council of State Housing Agencies.

less than the statewide median household income. We found that, overall, South Carolina, has served slightly higher income families than the other southeastern states. South Carolina has financed mortgage loans to families with an average of 98% of median income, whereas the other seven states, collectively, have served families with an average of 89% of median income.

Conclusion

State and federal law governing the homeownership program has changed considerably since its inception in 1979, and the authority has substantially complied with laws pertaining to who can be served. While South Carolina has served higher income families, on average, than other southeastern states, it now has the authority to more narrowly restrict who can be served.

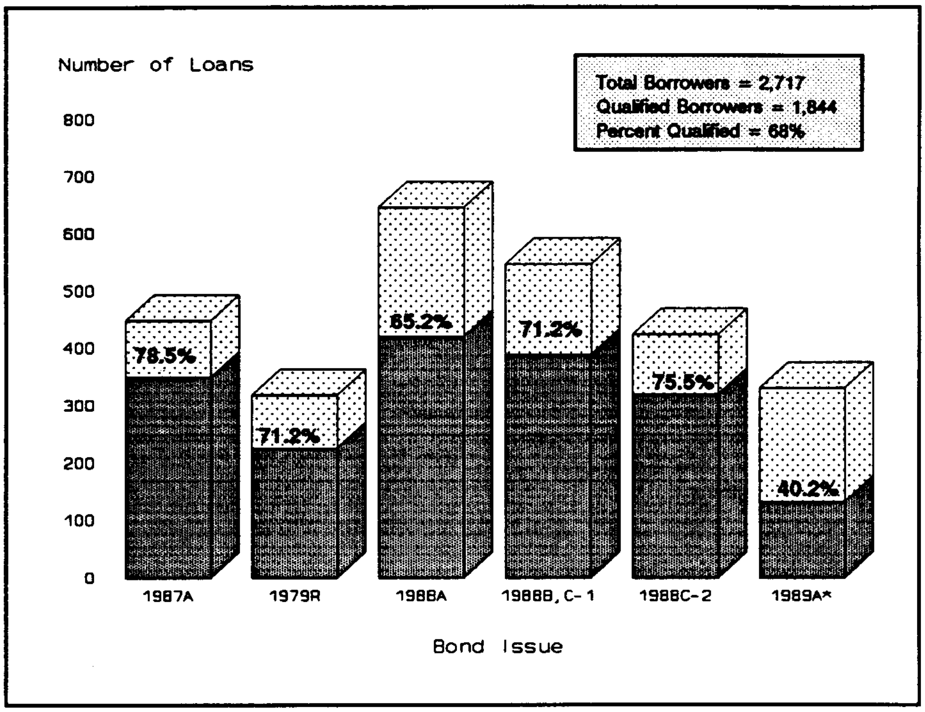
Borrowers Potentially Eligible for Private Loans

We estimated that more than two-thirds of the families who received subsidized below-market-rate mortgage loans from the State Housing Finance and Development Authority probably could have obtained private conventional or federally insured mortgages. We analyzed 2,717 authority loans made from December 1987 through June 1990. Based on this analysis, we estimated that 1,844 (68%) of the borrowers had enough income to qualify for private loans. The number of loans received by borrowers who probably could have obtained loans elsewhere may have limited funds available for families who could not afford to buy without an authority loan.

Our analysis was based on methodologies used by the General Accounting Office and other states in their evaluations of mortgage revenue bond programs. We did not include borrowers' total debt in our analysis because this data was not readily available. Our analysis could only result in an estimate because lenders' loan approval decisions are dependent on the facts of each individual case, which cannot be exactly quantified. For further explanation of our methodology, see Appendix B.

The results of our analysis are summarized by bond issue in Graph 2.1. We found that the authority's loans were received by the highest percent of borrowers who might otherwise not be able to purchase homes in the 1989A bond issue, where the authority set income limits below the federal maximums (see p. 29).

Graph 2.1: Estimated Borrowers Who Could Qualify for Private Loans as a Percent of Total Borrowers



*Includes 21 loans from the 1990A,B bond issues.
Source: State Housing Finance and Development Authority and LAC analysis.

Bonds should be used to make homeownership possible for households that otherwise could not afford it.

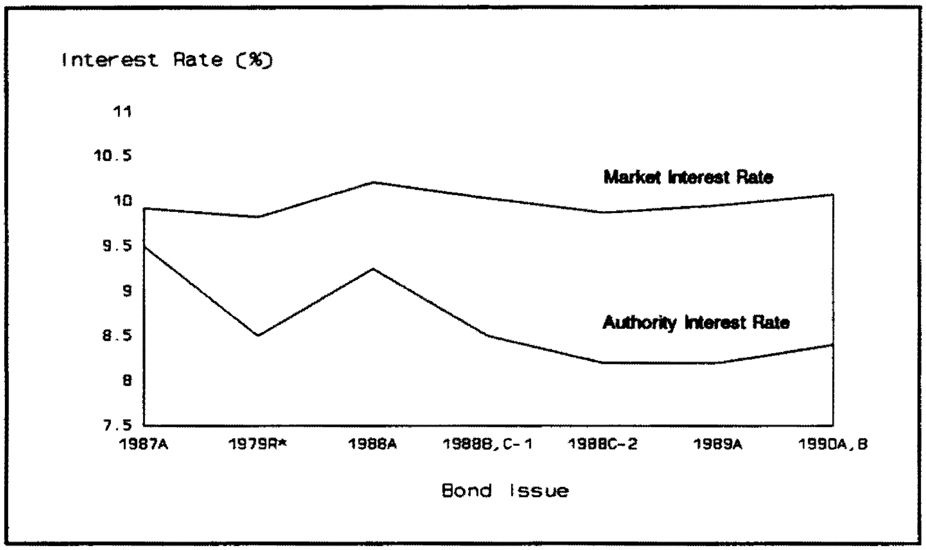
One measure of the effectiveness of a mortgage revenue bond program is the extent to which the program serves borrowers who cannot qualify for private financing, but can meet the obligations of a loan with a below-market interest rate. A 1980 National Council of State Legislatures/Municipal Finance Officers task force developed guidelines for mortgage revenue bond programs. The guidelines stated that mortgage revenue bonds should be used as one tool to make homeownership possible for households that otherwise could not afford it. Also, the bond programs should be designed to minimize competition with the private sector.

In our review of other states' reports about their mortgage revenue bond programs, we noted that Virginia and Minnesota have statutory provisions that borrowers must not be able to obtain financing on reasonably equivalent terms from private lenders. The laws of other southeastern states, including Tennessee, North Carolina, Georgia, Alabama, and Mississippi, mandate consideration of the ability of the borrower to obtain housing in the private housing market as a factor in determining eligibility.

The South Carolina Code of Laws does not have any requirement that the borrower's ability to obtain conventional financing be considered. However, before bonds can be issued, §31-13-200 states the authority must determine that "sufficient persons or families of either beneficiary class are unable to pay the amounts at which private enterprise is providing decent, safe and sanitary housing . . . ."

The difference in interest rates for authority loans and conventional loans has not been great enough to make homeownership affordable for a large number of borrowers who could not afford private mortgages. For the loans we reviewed, the overall average difference between the market interest rate and the authority's interest rate was 1.24 percentage points. The average rate differences for each bond issue are shown in Graph 2.2. If a family borrowed $50,000 at 9% instead of 10.24%, the difference in the monthly payment (including estimated taxes and insurance) would be $53. This illustration helps explain why many of the authority's borrowers probably could have obtained private conventional or federally insured loans.

Graph 2.2: Authority's Interest Rate Compared to Average Market Interest Rate By Bond Issue



*The authority reissued some 1979 bond funds beginning in 1988. The authority rate for 19 special program loans in this issue was 8%.
Source: State Housing Finance and Development Authority, Federal Home Loan Bank Board, and LAC analysis.

Recommendations

1 The General Assembly may wish to consider enacting legislation to ensure that the State Housing Finance and Development Authority's homeownership program serves borrowers who could not otherwise afford to buy homes.

2 In the absence of statutory change, we recommend that the authority implement policies and procedures to more effectively target borrowers who could not obtain financing in the private market.

Statewide Participation in Homeownership Program

We examined the State Housing Finance and Development Authority's system for ensuring that loans are provided to qualified applicants throughout the state. We found that the homeownership program has primarily served urban areas and that the authority has not maintained records of the locations of lenders who participate in the program. In addition, the authority should consider increasing publicity of the availability of mortgage funds in rural areas.

Distribution of Homeownership Loans

The authority does not allocate or distribute mortgage funds based on a county's housing needs, population or other factors. The authority's practice has been to provide mortgages to qualified applicants on a first come, first served basis. As a result, the majority of mortgage funds to assist homebuyers has gone to five urban counties. These five counties received 51% of the mortgage funds from January 1979 through June 1990 but had only 33% of the population (see Table 2.5).

Table 2.5: Counties Receiving the Majority of Mortgage Funds from January 1979 through June 1990

		Percentage of	
County	Mortgage Funds	Total Mortgages	State's Population
Richland	$126,326,649	16.14%	8.25%
Lexington	79,712,455	10.18%	4.94%
Charleston	70,821,155	9.05%	8.56%
Greenville	61,931,578	7.91%	9.04%
Dorchester	61,158,852	7.81%	2.31%
Five-County Total	399,953,686	51.09%	33.10%
State Total	**$782,892,936**	**100.00%**	**100.00%**

Source: State Housing Finance and Development Authority and 1989 South Carolina Statistical Abstract population estimates.

Rural Counties Have Benefited Less Under the Homeownership Program

Rural counties have benefited less under the homeownership program. For example, the five counties receiving the least amount of mortgage funds received 0.27% of the funds loaned, although they have 2.5% of the state's population. Factors affecting the number of mortgages to rural areas could include lack of adequate housing, employment and income. In addition, the Farmers Home Administration provides home mortgages in rural areas. In federal fiscal years 1989 and 1990, the Farmers Home Administration provided $87.1 million for 2,848 home mortgages.

We also analyzed where loans have been made from January 1987 through June 1990. No loans were made in three counties, and six counties obtained one loan each. In contrast, seven counties received approximately 75% of the funds loaned during this period (see Figure 2.1). Appendix C provides the total amount of mortgages made in each county.

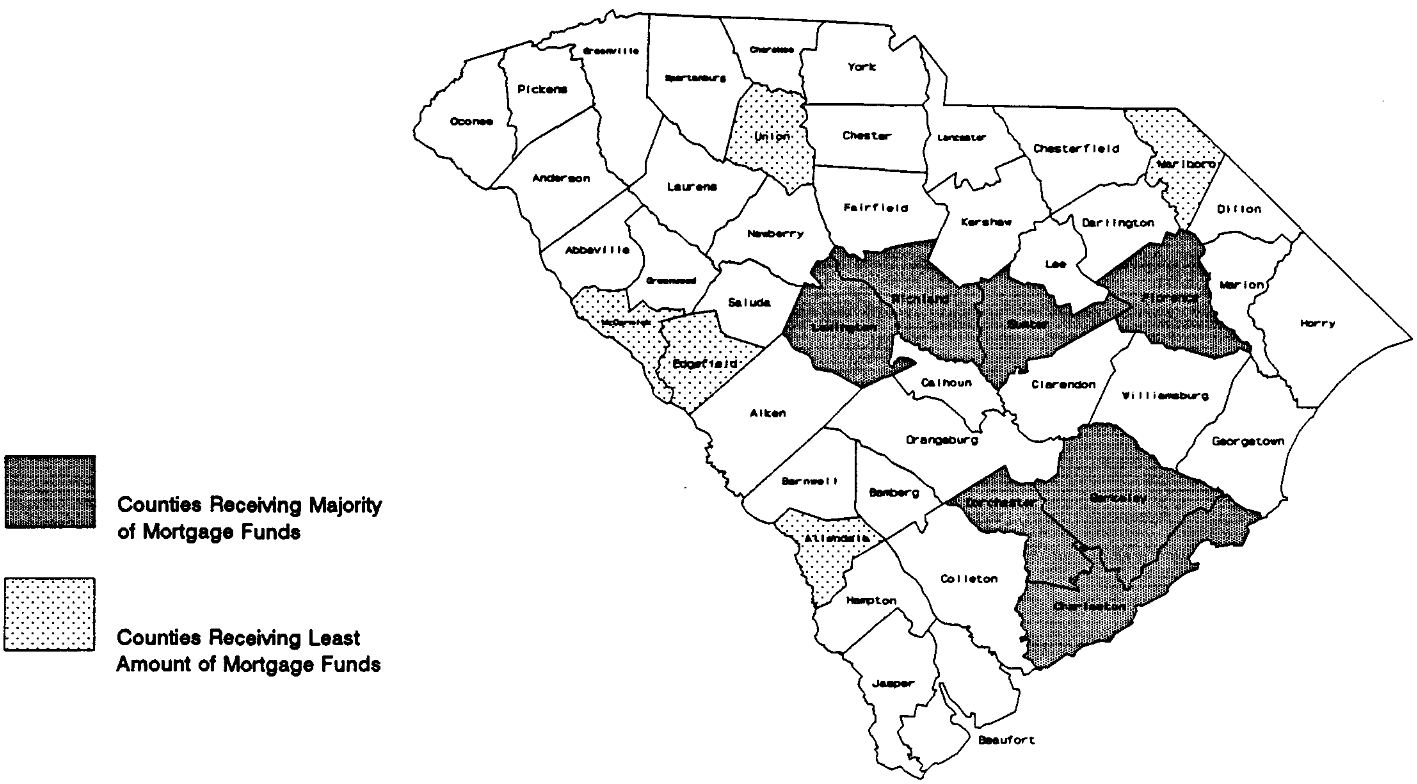
Our survey of seven southeastern states found that Mississippi, Florida and Georgia have used a system for allocating mortgages throughout their states. We also found that Minnesota allocates funds to counties based on housing vacancies, income-eligible renter households and other factors.

The authority has recognized that rural areas have been underserved. In October 1990, the authority approved a program to target loans to 23 counties that have received five or fewer loans since 1988.

Recommendation

3 The State Housing Finance and Development Authority should regularly evaluate the geographical distribution of mortgages in its homeownership program. The authority should consider taking action to ensure that rural areas are adequately served.

Figure 2.1: Counties Receiving 75% of Mortgage Funds Compared With Counties Receiving the Least Amount of Mortgage Funds From January 1987 Through June 1990



Source: State Housing Finance and Development Authority.

Lender Participation

Authority officials stated that a shortage of lenders in rural areas has caused these areas to be underserved. We asked the authority for a list of participating lenders, their branch locations, and the counties in which they are located. However, the authority has not maintained these records. We reviewed records of where lenders have made loans from January 1987 through June 1990. The fewest number of lenders serving a county was 5, while three counties were served by 18 lenders. We could find no evidence that a lack of lenders has caused rural areas to be underserved.

We also found that the authority has not consistently informed the public of which lenders make loans in their cities or counties. By contrast, North Carolina provides the public with brochures which list participating lenders, their locations, and their phone numbers.

Recommendation

4 The State Housing Finance and Development Authority should determine the location of all participating lenders and their branch locations. The authority should inform the public of participating lenders in each county.

Loan Publicity

The authority has not developed an ongoing program to publicize the availability of loans to underserved counties. The authority sends press releases to radio and television stations, and newspapers announcing the availability of mortgage funds. While these efforts help to inform the public of the availability of loans, special advertising in underserved areas of the state might help increase homeownership in these areas. The authority's records indicate that, in 1988, the authority purchased advertising in 57 "small" newspapers throughout the state to advertise the availability of loans. Commission minutes indicate that this advertising helped increase rural participation.

We contacted seven southeastern states to determine how they publicize loans. North Carolina sends information through local organizations and special press releases to the western and northeastern parts of the state. Tennessee obtains free public service announcements on television.

Recommendation

5 The State Housing Finance and Development Authority should consider purchasing special advertising in underserved areas of the state to inform the public of the availability of below-market-rate home loans.

Minority Participation in the Homeownership Program

We were asked to examine the extent to which minorities have been served by the authority's homeownership program. The authority has not maintained statistics about the number of minorities served since the program's inception in 1979. However, authority records indicate that from 1987 to June 30, 1990, minorities have received 481 (17%) of the 2,784 loans. These loans account for 15% of the mortgage funds. The authority has depended on lenders to determine the minority status of borrowers; however, it has not provided adequate guidance for collecting this information. As a result, the reliability of the authority's minority statistics is questionable. According to an authority staff member, they are working on a system to ensure more accurate collection of minority data.

The executive director indicated that the authority needs to take a more active role in providing homeownership opportunities to minorities, who make up approximately 32% of the state's population.

Recommendations

6 The State Housing Finance and Development Authority should implement procedures to ensure consistent minority data collection.

7 The authority should examine its minority participation and consider whether special efforts to increase minority participation are warranted.

Strategies to Maximize Program Results

Introduction

The authority's mortgages would ideally go to those who most need assistance in order to purchase a home. Homeownership programs can use a variety of methods to more precisely target this population. This chapter reviews the authority's use of targeted areas, purchase price limits, family size requirements, and loan distribution policies to improve program results. We also examined the authority's special alternative loan programs for lower income recipients, and reviewed alternative programs in other states.

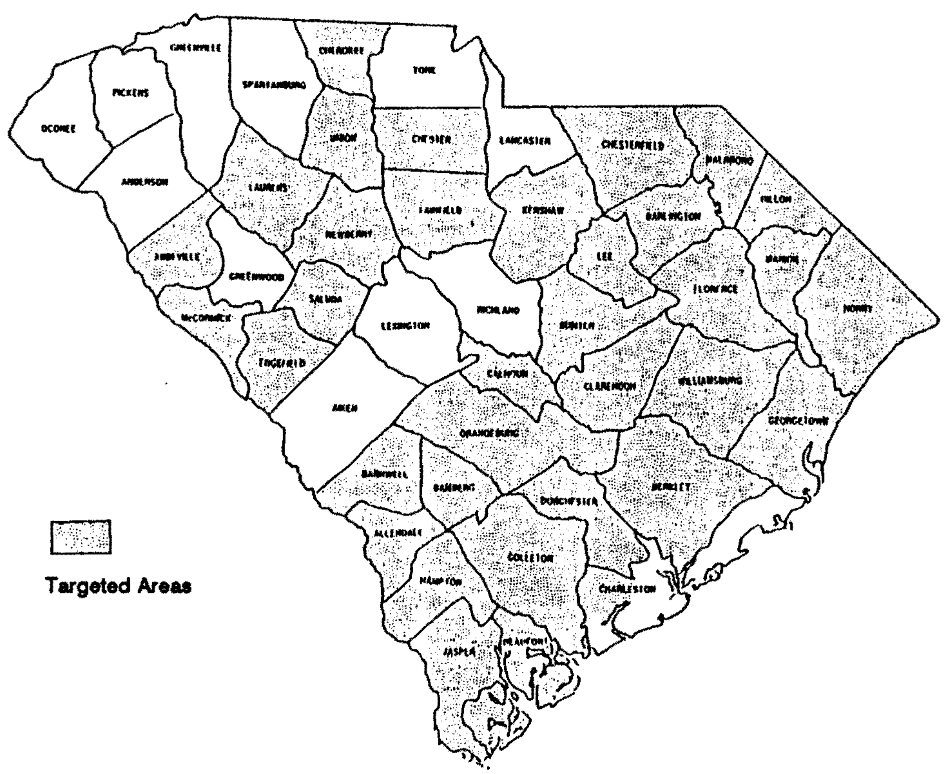
Targeted Areas

In 1980, the federal government authorized states to designate economically distressed areas as "targeted areas" upon obtaining the approval of the Departments of Treasury and HUD. The designation must be based on such factors as the condition of housing and the need of area residents for mortgage financing (low per capita income, high level of poverty, high number of welfare recipients, and high unemployment rates). At least 20% of mortgage funds from a bond issue must be made available in targeted areas. The borrower eligibility requirements are relaxed for targeted areas in that the first-time buyer requirement is waived, and the federal maximum income and purchase price limits are higher than for nontargeted areas.

The State Housing Finance and Development Authority obtained federal approval of its designated targeted areas in 1982. Those areas (which have remained the same since October 1982) cover much of the state and are indicated on Figure 3.1. According to authority staff, they tried to designate as targeted as much of the state as possible, primarily to remove the first-time homebuyer requirement. This would allow, for example, more families moving into the state to qualify for the program.

We determined the percentage of mortgage funds which have been used in targeted areas from bond issues 1987A through 1989A (through June 30, 1990). We found that, for each bond issue, at least 48% of proceeds were used in targeted areas, and, cumulatively, for the period reviewed, 54% of proceeds were placed in targeted areas. However, even though minimum federal requirements have been exceeded, many targeted rural counties have been underserved when compared with urban areas (see p. 17). The official designation of targeted areas does not ensure that more lower income families get loans.

Figure 3.1: Authority's Targeted Areas (Designated Areas of Chronic Economic Distress)



Source: State Housing Finance and Development Authority

Purchase Price Limits

The State Housing Finance and Development Authority has not regularly used purchase price limits as a way to target assistance to lower income borrowers. As a result, the amount of mortgage funds used by families in the higher income group of eligible borrowers, who would be more likely to purchase expensive property, may have been greater than if the authority had established lower limits.

Since 1980, the federal government has placed limits on the purchase prices of homes that can be acquired with the proceeds of the authority's bonds. The allowable purchase price cannot exceed 90% of the average area purchase price (110% for targeted areas). Agencies can establish limits below the maximums to meet program objectives.

The authority has generally used the maximum federal purchase price limits since 1985. The authority set limits lower than the federal limits in its 1985B bond issue, and reported to the Internal Revenue Service in 1986 and 1987 that it intended to continue this approach as an effective way to target funds, "to be use[d] by persons and families with lower income levels." However, the authority did not continue this policy, but used the maximum federal limits for each succeeding bond issue, except for its 1979 reissue funds, through the 1989A bond issue (see Table 3.1).

Limits for the 1990 bond issues have been set generally lower than the federal limits based on FHA maximum mortgage limits. However, since all loans in the 1990 issues are FHA loans, borrowers could not purchase homes that cost more than the FHA limits.

Table 3.1: State Housing Finance and Development Authority Purchase Price Limits, 1987-1990

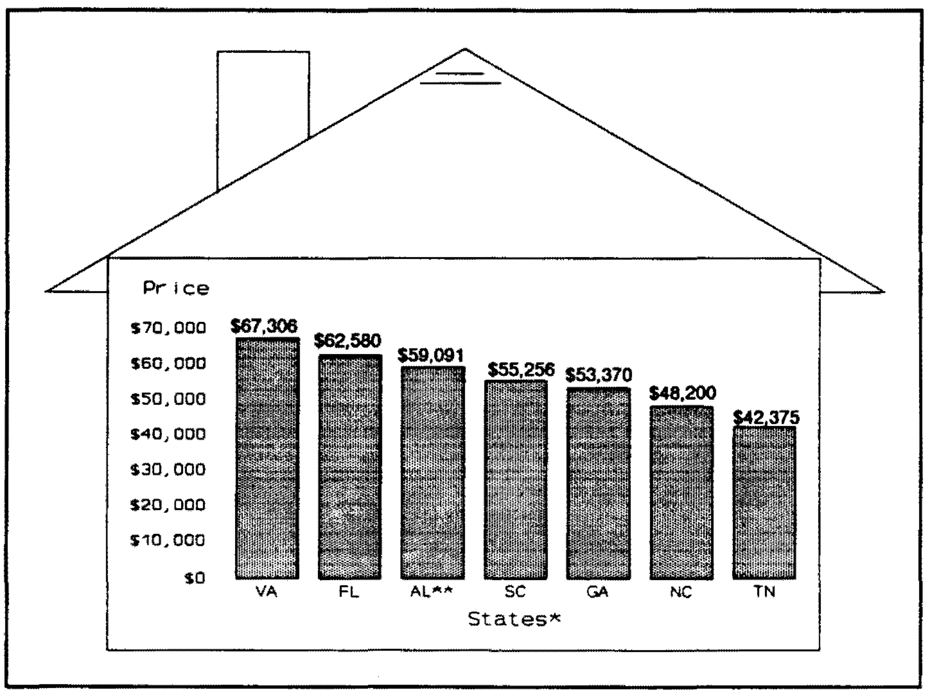
Bond Issue	Purchase Price Limits	Range[c]
1987A	Federal Maximum	$57,780 - $97,240
1979r[a]	Authority Set Price	$46,000
1988A	Federal Maximum	$57,780-$97,240
1988B,C-1	Federal Maximum	$73,530-$97,790
1988C-2	Federal Maximum	$73,530-$97,790
1989A	Federal Maximum	$73,530-$97,790
1990A,B	Authority Set Limits[b]	$76,500-$93,000

[a]Authority reissued some 1979 bond funds in 1988.
[b]Authority set limits based on FHA mortgage limits.
[c]Range of maximum purchase prices for new and existing housing in different areas of the state.
Source: State Housing Finance and Development Authority.

Some other states have established lower purchase price limits to target loans to low income families. Six of twenty-five issuing agencies (state and local) in a 1988 General Accounting Office study used this approach. Tennessee has set its purchase price limits well below the maximum federal limits in the belief that people who can afford to buy higher priced homes will not be willing to purchase the homes available at lower prices, and will apply for conventional loans. According to a Tennessee official, as a result of the agency's low purchase price limits, loans have been pushed to the state's rural areas.

We reviewed data on the average purchase price for homes obtained in the homeownership programs of seven southeastern states for the years 1987 through 1989. The results of this comparison appear in Graph 3.1.

Graph 3.1: Average Purchase Price for Bond-Assisted Families 1987-1989



*Data from Mississippi was not available.
**Data for 1987 not available; two-year average.
Source: National Council of State Housing Agencies

Real estate prices vary in different areas. For example, the federally determined average area purchase prices for 1990 vary within South Carolina from $70,400 to $114,600, and within North Carolina from $68,400 to $133,900. In areas where overall real estate prices are higher, bond-assisted buyers would tend to pay more for their homes.

However, the lower purchase price limits set by states such as Tennessee may have resulted in more program assistance being received by lower income borrowers than in states such as South Carolina that have generally had higher purchase price limits. The authority's executive director stated that he would prefer to target assistance by lowering income limits rather than by using market controls such as purchase price.

Recommendation

8 The State Housing Finance and Development Authority may wish to consider using lower purchase price limits as a way to target assistance to lower income borrowers.

Targeting By Family Size

Another strategy the authority can use to maximize the number of persons served is to further adjust income eligibility according to family size. By setting higher income limits for larger families than those allowed for smaller families, an agency can serve more persons and better ensure that its mortgages go to families that most need them.

For bonds issued after December 31, 1988, federal law established separate income limits for families of two or less and families of three or more. The authority has applied this method in its three most recent bond issues (1990A, B and C). However, federal limits do not prohibit additional ranking by family size within those limits.

As an example of adjusting income eligibility by family size, state law provides for an allowance for each family member equal to the amount of the Internal Revenue Code personal income tax exemption. In two programs since 1987, the authority has used an income adjustment of $800 per person for families of two or more, to establish higher eligibility limits for larger families (see 1989A, p. 29; and Hugo, p. 30).

In a third program beginning in 1989, the authority applied the 1988 personal exemption amount of $1,950 (see CHOP, page 30). The current (1990) federal personal exemption amount is $2,050.

According to authority officials, since the amendment of the authority's statute in March 1990, its board of commissioners has the power to implement any method of targeting deemed appropriate, which would include further targeting by family-size income adjustments.

Recommendation

9 The State Housing Finance and Development Authority may wish to consider making additional income eligibility adjustments based on family size as a means to direct mortgages to those who most need them.

Targeting Loan Distribution

In 1984, Congress stated its intent that states use mortgage revenue bonds to assist lower income borrowers in purchasing homes before assisting higher income borrowers. States were required to report their compliance with this intent on an annual basis until the reporting requirement was repealed by the Tax Reform Act of 1986.

The authority responded to the mandate to assist lower income borrowers first by making modifications to its loan distribution process. The authority generally follows a policy of first-come, first-served in making loan funds available. This could allow all available funds to be used quickly by qualified borrowers who heard about the loan funds first (see p. 17).

Beginning with the 1985B bond issue, the authority has used loan distribution to target lower income borrowers in two ways. First, for some bond issues (1985B, 1988A, and 1988B,C-1), the authority has made loans available for a 30-day period to low income borrowers prior to making them available to those with higher incomes. For the 1988 bond series, families with incomes not exceeding $21,000 could obtain loans during the 30-day periods.

Second, the authority has made loans available from two different bond issues at the same time, and established lower income limits for loans from one of the issues. The authority has not maintained separate records of loans reserved for low income families during the 30-day exclusive periods since 1987. Thus, we could not evaluate the results of this approach. However, according to an authority staff member, the authority prefers the second method because it ensures that lower income borrowers have access to loan money for a more extended period of time.

Assistance for Low Income Families

We examined seven programs that the authority has implemented to assist lower income families in purchasing homes. Five programs have been financed with mortgage prepayments (funds available when borrowers pay off their mortgages early). A sixth program used bond proceeds to provide mortgages for lower income families, and a seventh program used investment income to provide cash assistance for down payment and closing costs.

Borrowers who participated in these programs had to meet the same mortgage underwriting requirements as borrowers in other authority mortgage programs, but there were special provisions concerning either who could be served and/or where the homes could be purchased. Our purpose was not to evaluate these programs, but to respond to our audit objective to determine how the authority's resources have been made available to lower income households, and determine what other initiatives could be considered.

In addition, we contacted other states to determine what initiatives they have taken to assist low income families in homeownership. These areas are discussed below.

1989A Mortgage Bonds

In November 1989, the authority provided $20 million in bond funds under the 1989A bond issue to provide mortgages to lower income families. To qualify, family income could not exceed $25,000 for a two-member family, with $800 added for each additional family member. These mortgages had an interest rate of 8.2%. As of June 30, 1990, 310 loans had been made in this program.

1979 Reissue Program

In 1988, the authority allocated prepayments totalling $12.5 million from bonds issued in 1979 to provide home mortgages for low income families. The interest rate for this program was 8.5%. The maximum family income to qualify for this program was $19,500, with $800 added for each family member. Authority records indicate 300 loans were made in this program.

Community Homeownership Opportunity Program

The authority has implemented the Community Homeownership Opportunity Program (CHOP) in cooperation with local governments to provide homeownership to lower income families. Under this program, local government entities and housing authorities submit proposals to the State Housing Finance and Development Authority. The local government provides resources such as land, water and sewer hookups, roads, and building permits to lower the cost of the housing. The authority provides mortgages for the homes. The authority has allocated $8 million of prepayments to provide mortgages with an interest rate of 8%. As of October 1990, approximately $3.3 million had been committed to 7 cities.

Hugo Program

In October 1989, the authority set aside $10 million from mortgage prepayments to provide mortgages for lower income persons in the 24 counties declared federal disaster areas as a result of hurricane Hugo. To qualify, an applicant must prove that his residence suffered damage from the hurricane.

The Hugo program has provided mortgages, at an interest rate of 8%, for 48 families in 6 counties. As of June 7, 1990, approximately $3.4 million in mortgage funds had been applied for or loaned. An authority official indicated that the remaining funds in the program will not be loaned after 1990. Any remaining funds can be allocated for other authority programs.

Low Income Equity Assistance Plan

In July 1989, the authority implemented the Low Income Equity Assistance Plan (LEAP) to aid low income households. In this program, the authority used $90,000 of interest earned on bond funds that had not yet been loaned. This program provided $1,500 to lower the down payment or closing costs for 60 families who received mortgages from the authority's 1989A bond issue. Families with annual incomes of $21,000 or less could qualify. An authority official indicated the program is no longer in place.

Other Initiatives

In 1988, the authority voted to budget $1.9 million of surplus program funds for four new programs. One program would have provided grants for down payment assistance. Another program was to help families living in small cities purchase a home. A third program was to help homeowners repair their homes, and the fourth would have helped elderly homeowners convert their home equity into cash. While these programs have not been implemented, the board has not voted to terminate them.

In October 1990, the authority approved two programs that were implemented in November 1990. One program was designed to assist lower income single parents in the purchase of a home. The other program provides mortgages to lower income families in counties that have been underserved by the authority's homeownership program.

Other States' Initiatives

We contacted other states which have initiated special programs to serve low income families. The following summarizes initiatives undertaken in five states to enable low income families to purchase a home.

Kentucky

Kentucky has a program which uses surplus funds from bond issues to provide mortgages with interest rates of 1% to 7% to low income families. The maximum income for a family of 4 to qualify is approximately $21,000.

North Carolina

North Carolina uses state funds, surplus bond funds, and mortgage prepayments to provide mortgages and down payment assistance for low income families. In 1989, $6.6 million was committed to assist 200 families; some had incomes of less than $8,000 a year.

Florida

Florida has a program which provides second mortgages at a maximum interest rate of 3% to assist low income families with down payments and closing costs. Each family can borrow $1,700. The Florida program targets families with incomes of 80% or less of the state median income, and is funded with state appropriations.

Virginia

The Virginia Housing Development Authority started a program, funded by a $45 million revolving loan fund, to assist families who could not be served by the agency's normal financing programs. Approximately $24 million has been used to provide mortgages for "very low income" families.

Minnesota

The Minnesota Housing Finance Agency uses funds from state appropriations to provide down payments, closing costs, and monthly payment assistance through an interest free second mortgage. The income limits for this program are $17,000 to $26,000, depending on the borrower's location.

Conclusion

The State Housing Finance and Development Authority has initiated programs to assist lower income families purchase homes. In addition, the commission has approved other programs to assist with down payments, closing costs, and homeownership; however, these programs have not been implemented. Other states have used agency funds and state appropriations to fund homeownership programs for low income families. If the authority determines that lower income families have been underserved, the authority could use existing resources to provide low interest mortgages, down payment assistance, second mortgages or to implement other initiatives to assist lower income families.

Recommendation

10 The State Housing Finance and Development Authority should evaluate alternatives and continue to implement programs which provide assistance for lower income families to purchase homes.

Program Administration and Resources

Introduction

We examined the authority's resources and resource management to determine whether the agency has surplus funds which could be used to assist lower income families in purchasing homes. We also looked at program administration to review the financial security of the bonds and determine whether the agency has adequate controls to ensure that borrowers meet program guidelines.

Resources for Housing Programs

We found that the authority has substantial unrestricted resources which could be used for housing programs. As of June 30, 1990, $22.9 million in unrestricted funds (some of which was committed) was held in the agency's 1979 single family bond accounts. Also, as of August 1990, the authority had $5.2 million in an agency program fund that can be used for any agency purpose. However, the authority has not clearly identified available resources and has not adequately planned for their use.

Bond Funds

The authority earns income by issuing bonds because the interest rate that it pays on the bonds is less than the interest rate earned on the mortgages. The amount the authority can earn is limited by the federal government; bonds issued since 1982 can earn up to 1 1/8 percentage points for the issuing agency. Some program expenses must be paid from these earnings.

The authority issues bonds in accordance with an official bond document, called an indenture or resolution, which contains requirements that govern the receipt and expenditure of bond funds. Excess earnings on bond funds are derived from interest on the mortgages, investment earnings, and from prepayments (borrowers paying off their mortgages early). Excess earnings on bond funds can be used to make additional loans or to pay off bonds. The authority's bond resolutions also permit the authority to transfer excess bond funds to its other funds if certain conditions are met. The authority can use transferred funds for any agency use. These uses could include interest free second mortgages, down payment assistance, closing cost assistance, or other initiatives to assist those who otherwise could not afford homeownership.

The authority has issued homeownership mortgage bonds under two different resolutions, one passed in 1979, and the second in 1982. As of June 30, 1990, there were no excess funds from the 1982 bonds which could be transferred to the authority. However, substantial excess funds have been earned from the 1979 bonds. We reviewed the financial status of these bonds, using the indenture's criteria for identifying surplus funds that could be transferred from the bond funds to the authority. As of June 30, 1990, the bonds had $235.3 million in assets and $212.4 million in liabilities, leaving $22.9 million in unrestricted funds.

Substantial excess funds have been earned from the 1979 bonds.

The portion of these unrestricted bond funds which could actually be transferred to the authority for uses other than mortgage loans depends on other factors, including program commitments made by the authority's commission. For example, as of June 30, 1990, the authority had committed more than $12 million for use in the CHOP and Hugo programs (see p. 30).

The authority has not regularly evaluated the bond funds to determine how much excess could be transferred to the authority's other funds, and has not adequately planned for the use of excess bond funds. A planning process would provide for the regular identification of surplus funds and establish priorities for their use. These uses could include transferring funds to the agency to be spent for any agency purpose, or leaving the funds in the bond indenture and using them to make loans for housing authority initiatives (see p. 29).

In 1982 and 1983, the authority transferred almost $6 million from the 1979 bond funds to fund other authority bond issues. Since 1983, the authority has left excess funds within the bond indenture and has periodically used prepayments to make new mortgages. These "recycled" mortgages amounted to $15.6 million by August 1990. The authority has not adopted a policy to use excess funds to make new mortgages, but its commission has approved this use on an ad hoc basis, on the recommendation of authority staff.

Some other states regularly evaluate and plan for the use of surplus bond funds. Wisconsin is required by law to identify and plan for the use of surplus bond funds on an annual basis. Virginia regularly transfers money from its restricted bond funds to its general fund.

Virginia has issued more bonds than South Carolina and has more excess funds. However, the regular identification of excess funds and planning for their use could aid the authority in ensuring the effective use of its resources.

Recommendations

11 The State Housing Finance and Development Authority should implement procedures to ensure the regular identification of surplus bond funds.

12 The authority should develop and implement a planning process for the use of surplus bond funds.

Profit Margin on the Bonds

The authority has not earned as much profit as allowed on its bonds. This may have limited the revenue available to pay administrative costs and support housing programs.

Since 1982, the federal government has limited the authority's spread (difference between the rate they earn on the mortgages and the rate they pay for the bonds) to 1 1/8 percentage points. The authority has not set up its bond issues to earn the full spread. For each bond issue since 1987A, there has been an unused portion of the spread ranging from .02 to .29 percentage points.

However, when the authority determines the interest rate it will charge on its loans, it must consider various factors. According to authority staff, its mortgage interest rate must be sufficiently below the market rate to attract borrowers. Also, the authority has tried to offer the lowest possible interest rates for borrowers. One other reason they would take less than the allowed profit would be to avoid having the mortgage rate be an "unusual" number (for example, 8.57%, as opposed to 8.5%).

When the authority does not take the full allowed spread, the loss of revenue over time could be substantial. (Though complex calculations would be required to estimate the amount foregone by the authority, a small portion of a percentage point difference in the yield on millions of dollars can be great. For example, .15% of $50 million is $75,000.)

The authority's excess revenue can be used for homeownership programs.

Recommendation

13 The State Housing Finance and Development Authority may wish to consider structuring any future bond issues to earn the maximum profit whenever market conditions allow.

Payment of Expenses

The authority has paid agency operating expenses from the 1979 bond funds. This is not in compliance with its 1979 bond indenture. The indenture authorizes the authority to pay program expenses with bond funds. However, the authorization applies only to expenses related to the bonds of that indenture (the 1979 bonds). The authority has paid its general operating expenses and expenses related to the bonds issued under the 1982 resolution with 1979 bond funds. For FY 87-88 through FY 89-90, 1979 bond funds have paid $4.3 million in agency operating expenses. The authority does not identify and allocate direct and indirect expenses to its individual programs, so we could not determine the amount of expenses related to the 1979 bonds.

Recommendations

14 The authority should implement accounting procedures to identify the direct and indirect expenses of each of its programs.

15 The authority should pay only authorized program expenses from its restricted bond funds.

Program Fund

As of June 30, 1990, the authority had an unrestricted balance of $5.2 million in a fund that can be used for any authority purpose. However, the authority has not promulgated regulations or issued guidelines for the use of these funds.

The authority's program fund was established by legislation initiated by the authority in 1986. According to Act 446 of 1986, the General Assembly found that it is in the public interest to assure the continued availability of housing assistance to the beneficiary classes, and the "assurance of housing assistance is directly related to the ready availability of Housing Authority funds." The program fund established by the Act was to provide a source of readily available authority funds. The authority could use these funds for any of its programs (rental or homeownership), free from the limitations of bond-derived funds.

According to §31-13-340 of the South Carolina Code of Laws, the authority is to deposit income from fees collected, other earned income and any investment income derived from fund assets into the program fund. All funds in the program fund have come from fees paid in connection with the authority's multi-family programs.

The balance in the program fund, as of June 30, 1990, was $5.2 million. The authority's commission discussed spending some of these funds in 1988 and authorized the budgeting of $1.9 million for innovative programs related to homeownership. However, these programs were not implemented, and, as of September 1990, the commission had no plan to use the program fund. The fund has not yet served its purpose as a source of readily available funds for housing assistance.

Expenditure From the Program Fund

In 1988, the authority reimbursed the state for its previous state appropriation of $451,463 from the program fund. This expenditure was not in compliance with state law. Section 31-13-340 states that the program fund may be used only in accordance with guidelines established in regulations promulgated by the authority. The authority has not promulgated regulations or issued guidelines for the expenditure of the program fund.

Recommendation

16 The authority should develop and implement a planning process for the use of its program fund, and promulgate regulations with guidelines for program fund expenditures.

Security of Mortgage Bonds

The authority has issued bonds that are financially secure. The issues we examined have been highly rated by Moody's Investors Services (Aa) and Standard and Poor's (AA-, and upgraded to AA in 1990). In addition, the authority has required each mortgage to have private mortgage insurance, be guaranteed by the VA, or be insured by the FHA. This insurance reimburses the authority up to 100% (depending on the insurance) of the outstanding balance of a defaulted mortgage.

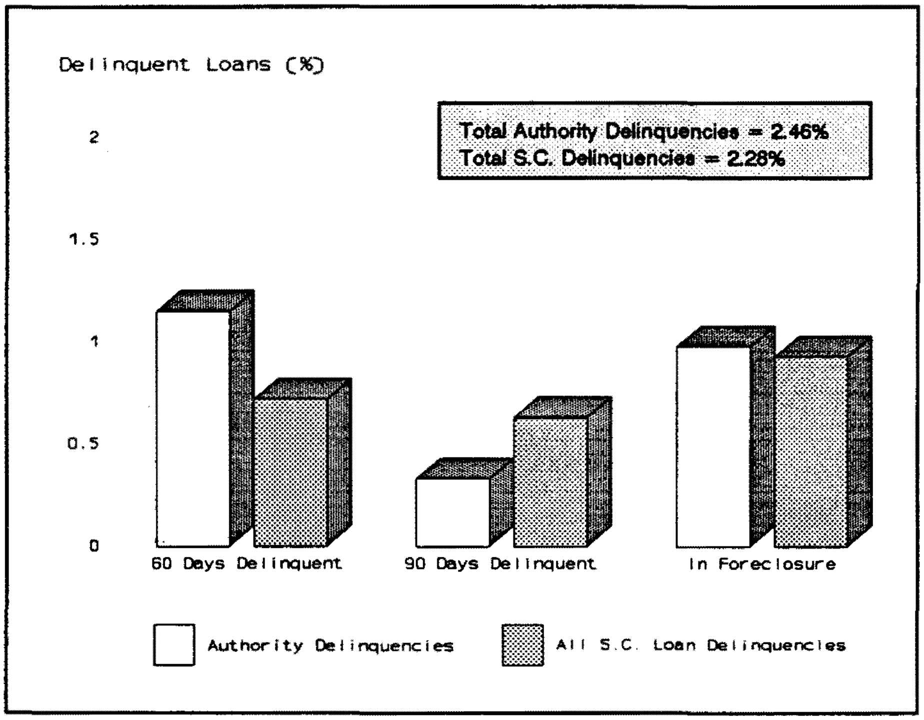
Bonds are Highly Rated

As of July 31, 1990, the authority had a balance of outstanding loans of $366 million on 8,100 loans made with the proceeds of bonds issued since 1982. The authority has two reserve funds to pay for potential losses from these loans that mortgage insurance may not cover. The bond indenture requires that a reserve of 3% of bond proceeds be established. In addition, a special reserve was established to pay for potential losses on mortgages with less than 99% insurance. As of June 1990, these funds had a balance of $16.8 million. As of October 1990, the authority had not suffered a loss on a defaulted loan.

Bonds issued by the authority do not constitute a debt of the state. The State Supreme Court has ruled that the state cannot use appropriated funds to repay mortgage revenue bond debts.

We examined delinquency rates of authority loans and compared them to delinquency rates for all South Carolina loans. Graph 4.1 shows that the delinquency rates for authority loans are similar to delinquency rates for all loans made in South Carolina.

Graph 4.1: Comparison of Authority Delinquencies to all South Carolina Mortgage Delinquencies as of July 31, 1990



Source: State Housing Finance and Development Authority and Mortgage Bankers Association.

Reports to the Trustee

The authority does not have adequate controls to ensure that it files documents with bond trustees as required by bond resolutions. The authority is required to make a number of reports to its bond trustees, First Citizens Bank for the 1979 bonds, and the State Treasurer's Office for bonds issued since 1982. These reports include annual cash flow projections, annual program budgets, annual reports of delinquent loans, and notice of defaulted loans. The reports ensure that the trustee of the bond funds is aware of conditions related to the financial status of the bonds.

We reviewed the authority's reporting and found that in some cases there was no documentation that required reports were submitted or that they were submitted in a timely manner. For example, some annual program budgets for earlier years were submitted to the trustee after we had requested them during the course of the audit.

Recommendation

17 The State Housing Finance and Development Authority should implement management controls to ensure that all reports to its bond trustees are submitted as required.

Internal Controls To Ensure Borrowers Meet Requirements

We reviewed the authority's internal controls for ensuring that borrowers who obtain the authority's mortgages meet program requirements. As part of this review, we examined the authority's loan approval process. We found that, combined with controls exercised by lenders and those who insure the authority's loans, the authority has sufficient levels of review to provide reasonable assurance that their borrowers meet program requirements.

We also reviewed a printout of information detailing 2,717 of the authority's loans made from December 1987 through June 30, 1990. We checked information about family incomes and home purchase prices to determine whether borrowers met program requirements. We reviewed documentation in the loan file in each case where there appeared to be a discrepancy. We found that for the 36 files with discrepancies, the errors could be attributed to incorrect information on the printout. All of the loans reviewed met the program requirements.

Appendices

Authority Income Limits, Average Borrower Income, and Statewide Median Family Income

Bond Issue	Authority's Income Limit	Average Borrower Income	Statewide Median Family Income
1979A	$18,800[b]	$16,055	$14,400[a]
1979B	$20,300[b]	$17,863	$15,600[a]
1982A	$29,600[b]	$23,153	$19,200
1983A	$29,600[b]	$23,507	$19,200
1983B	$29,600[b]	$23,464	$19,200
1984A	$35,417[b]	$26,860	$23,078
1985A	$35,417[b]	$26,731	$23,078
1985B	$35,424[b]	$26,224	$23,078
1987A	$38,640[c]	$28,529	$26,400
1979r	$20,300[b]	$18,629	$27,900
1988A	$40,460[c]	$28,119	$27,900
1988B,C-1	$43,540[c]	$28,996	$29,700
1988C-2	$43,540[c]	$31,508	$29,700
1989A	$25,800[d]	$20,384	$29,700
1990A,B	$36,200[e]	$26,692	$31,500

[a]Unverified figures.
[b]This includes an allowance of $800 ($807 for 1985B) for one family member; maximum income would increase by $800 for each additional family member.
[c]Maximum income varies by county; this reflects the highest maximum for any county.
[d]Income limits are based on household size (for example, $23,400 for one person; $29,000 for seven persons; add $800 for each additional person above seven). The figure shown in the chart is for a family of three.
[e]Maximum income for family of three or more persons; for family of one or two persons, the maximum is $31,500.

Source: State Housing Finance and Development Authority, State Budget and Control Board, and U.S. Department of Housing and Urban Development

Methodology Used to Estimate Borrowers Who Could Qualify for Other Loans

In order to estimate the extent to which the authority's borrowers could have obtained private conventional or federally insured mortgages, we analyzed 2,717 authority loans made from December 1987 through June 1990.

We used interest rate data for South Carolina provided by the Federal Home Loan Bank Board to determine the average conventional loan interest rate for the months the authority's borrowers obtained their loans. We calculated the minimum income that each of the 2,717 families would have needed to qualify for the amount of their mortgage. If the family's actual income exceeded the minimum needed, we concluded they had enough income to qualify for a conventional loan.

We based our analysis on an industry standard that allows up to 28% of income to be applied to housing expenses (principal, interest, taxes and hazard insurance). Most authority loans did not have to meet this standard, because 94% of the loans we reviewed were insured by the Federal Housing Administration (FHA) or guaranteed by the Veterans Administration (VA). The income and debt requirements for FHA and VA borrowers are not as strict as for conventional borrowers. Also, the interest rates obtained by VA and FHA borrowers are frequently lower than the conventional rates we used. We used data from the U.S. League of Savings Associations to estimate the percent of a borrower's monthly payment that is comprised of taxes and hazard insurance (14.2%).

We assumed that the borrowers were obtaining 30-year fixed-rate loans and that they could meet other eligibility requirements such as satisfactory credit and employment records. These requirements are similar for authority and private loans. We did not include borrowers' overall debt or their down payment and closing costs in our analysis. However, the authority's VA and FHA borrowers must meet the down payment requirements of these agencies. Also, closing costs can be financed as a part of the mortgage for FHA loans, unlike conventional loans.

Amount of Mortgages by County, January 1, 1979 to June 30, 1990

County	Mortgage Funds	Percentage of Total	1987 County Population	Percentage of Total
Richland	$126,329,646	16.136	282,400	8.249
Lexington	79,712,455	10.182	169,000	4.937
Charleston	70,821,155	9.046	293,100	8.562
Greenville	61,931,578	7.911	309,400	9.038
Dorchester	61,158,852	7.812	79,100	2.311
Spartanburg	40,180,728	5.132	214,100	6.254
Florence	39,499,843	5.045	117,000	3.418
Berkeley	34,630,314	4.423	130,000	3.797
Sumter	33,816,409	4.319	96,700	2.825
Horry	27,169,256	3.470	135,000	3.943
Kershaw	22,130,927	2.827	43,100	1.259
Anderson	18,750,316	2.395	141,400	4.130
Aiken	17,571,829	2.244	119,900	3.502
York	16,806,378	2.147	124,500	3.637
Beaufort	15,659,463	2.000	83,700	2.445
Orangeburg	15,536,320	1.984	88,200	2.576
Darlington	14,230,774	1.818	64,900	1.896
Pickens	11,843,064	1.513	88,300	2.579
Greenwood	9,480,972	1.211	58,300	1.703
Cherokee	9,102,055	1.163	41,800	1.221
Lancaster	8,659,995	1.106	55,500	1.621
Oconee	6,140,222	.784	54,000	1.577
Laurens	4,505,158	.575	53,200	1.554

Chesterfield	4,033,611	.515	38,900	1.136
Newberry	3,643,330	.465	32,100	.938
Georgetown	3,205,492	.409	48,100	1.405
Colleton	2,761,202	.353	34,700	1.014
Clarendon	2,754,255	.352	28,300	.827
Lee	2,597,362	.332	18,500	.540
Barnwell	2,517,998	.322	21,000	.613
Marlboro	2,083,436	.266	31,600	.923
Marion	2,011,011	.257	35,000	1.022
Dillon	1,937,336	.247	32,500	.949
Bamberg	1,355,687	.173	18,100	.529
Chester	1,070,652	.137	31,000	.906
Williamsburg	1,034,610	.132	38,300	1.119
Calhoun	1,095,250	.140	11,800	.345
Hampton	818,160	.105	19,100	.558
Saluda	766,850	.098	16,200	.473
Edgefield	742,950	.095	18,400	.537
Abbeville	698,680	.089	22,500	.657
Jasper	662,710	.085	15,200	.444
Union	629,170	.080	30,300	.885
Fairfield	538,125	.069	21,400	.625
McCormick	154,650	.020	7,200	.210
Allendale	112,700	.014	10,600	.310
Totals	$782,892,936	100.000	3,423,400	100.000

Source: State Housing Finance and Development Authority and 1989 Statistical Abstract population estimates.

Agency Comments

SOUTH CAROLINA STATE HOUSING FINANCE AND DEVELOPMENT AUTHORITY
1710 GERVAIS STREET, COLUMBIA, SOUTH CAROLINA 29201
Post Office Box 7008, Columbia, South Carolina 29202-7008

March 7, 1991

Mr. George L. Schroeder
Executive Director
Legislative Audit Council
400 Gervais Street
Columbia, South Carolina 29201

Dear Mr. Schroeder:

The State Housing Finance and Development Authority has completed its review of the Legislative Audit Council Report on the Homeownership Program and welcomes this opportunity to file its comments.

The Authority is especially pleased that, after six months of intense scrutiny by your staff, no instance of violation of federal or program requirements was found. Your report states that the Authority had sufficient levels of review to ensure compliance (page 42).

In your review of controls and security of Homeownership funds, the only questionable comment concerned the Authority's withdrawal of funds from the 1979 Indenture for the expenses of the Authority as a whole. The withdrawal of funds for this purpose was legitimate; however, the terminology was incorrect. A change to this procedure has now been implemented.

Recognizing the fact that your audit review examined a program where $950,855,000 in Bonds have been issued providing over 20,000 mortgages to the citizens of South Carolina, we believe the insignificance of the findings stated above are remarkable. We are pleased that your report confirms the excellent work being performed by the Authority.

We feel that the Report, in general, was successful in its discussion of a program containing very complex statutory, regulatory and public policy issues. We appreciate your staff's efforts to understand the Program and to make their recommendations based upon their research.

As Executive Director, it is my responsibility to identify

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those statements and conclusions which I feel do not properly represent the current focus or public purpose of the Authority's Homeownership Program. Act No. 370 of 1990 enabled the Authority, for the first time, to target specific groups within the statutorily-created "beneficiary classes". Prior to this Act, the Authority was obligated to serve all members of the "beneficiary classes", as defined by the General Assembly. Since March, 1990, the Program has experienced a major policy shift. The Authority today is reaching those members of the Beneficiary Class who can best benefit from affordable homeownership opportunities, as required by Congress. While the Report alludes to these changes, the significance is obscured by the focus on activities in prior years.

As stated earlier, we feel that the Report, in general, is effective. However, there are certain comments and recommendations which we feel should be addressed further:

1. Your recommendation No. 6 states that the Authority should implement procedures to ensure consistent minority data collection. With regard to minority participation in the Authority's Program, page 21 of the Report contains the following statement: "The Authority has depended on lenders to determine the minority status of borrowers; however, it has not provided adequate guidance for collecting this information." Information regarding an applicant's minority status is not required to be provided at the time of application; an applicant has the right to refuse to provide this information.

The Department of Housing and Urban Development (HUD) has advised counsel to the Authority that provisions of the Equal Credit Opportunity Act (ECOA) forbids the collection of this information other than on a voluntary basis. The Authority's lenders are familiar with the requirements of both HUD and ECOA as further defined by Federal laws relating to the Home Mortgage Disclosure Act and the Federal Fair Housing Law. The Authority is advised that any additional guidelines it might seek to impose would be invalid.

2. Recommendation No. 8 says the Authority may wish to consider using lower purchase price limits as a way to target assistance to lower income borrowers. The text and tables relating to purchase price limits do not point out that the Authority lowered Purchase Price Limits in 1990. In addition, uniform statewide limits and elimination of higher purchase price limits for targeted areas were adopted. It also lacks a comparison of purchase price limits to the actual average

purchase prices by bond issue. Table 3-1 on page 25 should include the following data in order to present actual Program experience:

Bond Series	Average Purchase Price
1987A	$55,769
1988A	58,103
1988B,C1	58,550
1988C2	63,323
1989A	49,701
1990A,B	59,170

3. Your statement on page 35 that the Authority has $22.9 Million in unrestricted funds is misleading. Some of the funds being held are bond principal resulting from early pay-off of mortgages. These amounts can only be used to purchase additional mortgages or to redeem outstanding bonds as outlined in the Bond Indenture.

In addition, as you stated on page 36, the Authority had continuing commitments in excess of $12 Million on June 30, 1990 for the Community Homeownership Opportunity Program (CHOP) and the HUGO program.

At its October, 1990 meeting, the Authority's Commissioners approved two new programs utilizing excess funds from the 1979 Single Family Mortgage Purchase Bond Indenture.

.$5 Million was set aside to provide mortgages for the Single Parent Homeownership Program. To be eligible, the Borrower must be an unmarried head of household with custody or legal guardian of at least one minor child.

.$10 Million was made available to qualified Borrowers in counties where the Authority's previous programs had been underutilized.

.For both programs, the maximum income for a one person household is $25,700 plus $800 for each additional household member. The interest rate on the mortgages is 7.75%.

With the implementation of the above programs, the Authority has total funds commited in excess of $27 Million, which was the amount deemed available in October, 1990.

4. The Authority has recognized that the use of the Program Fund for reimbursement to the State of its State Appropriation for Fiscal Year 1987, while well intentioned, was not correct. This action was reversed by a Resolution of the Board of Commissioners at its January, 1991 meeting, and the funds were returned to the Program Fund in February, 1991.

Again, I would like to express my appreciation for the scope and thoroughness of your review. I can assure you that the Authority will consider your findings and recommendations. We will utilize your analysis in our efforts to continually improve on our successes in providing affordable homeownership opportunities for the citizens of South Carolina.

Sincerely,

E. Anthony Buzzetti

E. Anthony Buzzetti
Executive Director

Legislative Audit Council

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